

AFRICA RISK CONSULTING

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The government and the main opposition Resistência Nacional Moçambicana (Renamo) party are in political deadlock over a final agreement about the integration of security forces. Standard & Poor's downgrades Mozambique's sovereign credit rating over concerns related to the debt of the government-owned tuna fishing company, Empresa Moçambicana de Atum SA (Ematum). Coal India Ltd (CIL) plans to exit 75% of its coal concession in Tete Province. United States (US)-based Anadarko Petroleum is in talks to sell liquefied natural gas (LNG) to a Japanese consortium. The Centre for Public Integrity, a Mozambique-based transparency advocacy non-governmental organisation (NGO), claims the government is ignoring possible natural gas price fluctuations in its contracts with LNG exporters.

Government and Renamo in political deadlock again

After an agreement in June on the separation of political parties from state entities, the government and **Resistência Nacional Moçambicana (Renamo)** started talks again to address key aspects of the agreement. However, the government and Renamo are at deadlock over who will submit the 'declaration of principles' of the separation of political parties from state entities to parliament. The deadlock will prolong the eventual completion of a final political deal between the ruling **Frente de Libertação de Moçambique (Frelimo)** and Renamo.

*"Renamo [argues] that the declaration should be submitted by President **Filipe Jacinto Nyusi** (2015- present) as a way to have it passed by the Frelimo deputies without questioning enough. But the government negotiating delegation says Renamo must submit the declaration itself. Without any consensus in this regard, the delegations have now passed number four and last point in the agenda, which is economic issues, leaving behind the military issues and the separation of political parties and the state still to be finalised. There have been many high figures in the security forces, police and in the army, who have retired in recent weeks ... with these changes, it is possible that some Renamo figures will be given posts in the security forces."*¹

Renamo leader **Afonso Dhlakama** said recently that he held indirect talks with Nyusi, through his advisers, in order to organise a meeting between the two, which is expected to find a definitive solution for the political crisis.² Dhlakama is demanding that a meeting produce tangible results, otherwise "there is no need for such meeting", and he will rule the six provinces, which he claimed to have won in recent elections, "by force" if necessary (see previous ARC Briefings for Mozambique).³ However, during an official visit to **France** between 19 and 21 July, Nyusi rejected Dhlakama's demand that Renamo govern the six provinces, where it obtained the majority of votes in the 2014 presidential elections. National and international observers agree that there were fraudulent acts during the elections but not significant enough to change the results that brought Nyusi to power.⁴

¹ Source, political analyst and university lecturer, Maputo

² Source, political analyst, Maputo

³ Source, political analyst, Maputo

⁴ Source political analyst, Maputo

Ematum debt leads to downgrade of Mozambique's sovereign credit risk rating

Ratings agency **Standard & Poor's** on 6 July downgraded Mozambique's sovereign credit rating to B.⁵ The downgrade will potentially increase the cost of international borrowing and the need for investors to secure increased partial risk guarantees. The cordial relationship between the government and international financial institutions reduces the risk of a debt default. The downgrade followed an unscheduled Standard & Poor's assessment in July. The downgrade relates to the possible restructuring of the government guaranteed \$850m loan to state-owned tuna fishing company **Empresa Moçambicana de Atum SA (Ematum)**.⁶ Standard & Poor's classified Ematum's debt as "distressed".⁷ Ematum's first debt installment is due in September amid concerns whether it will meet its commitments following persistent losses.⁸ Standard & Poor's estimates Ematum's principal and interest payments at approximately \$260m annually over the next five years.⁹ Standard & Poor's warned that the sovereign guarantee that the government issued to Ematum "raises broader questions about Mozambique's governance and public sector debt management".¹⁰

The renegotiation could involve the lengthening of the repayment period at a lower interest rate, but there is uncertainty about the government's exact strategy towards Ematum's debt.

*"We're not sure whether the government is looking for a renegotiation or a restructuring. No one knows at the moment but we are definitely keeping an eye on it."*¹¹

Local media on 14 July quoted economist and academic **Ragendra de Sousa** as saying that the downgrade will not deter investors who will view it as a legacy of the previous government rather than indicative of the current administration.¹² De Sousa provided additional clarification as to the challenges facing Ematum.

*"The first problem is the payment deadline. The second is that this is commercial debt with very short maturity and a high interest rate, meaning that Ematum has to produce large tonnages to be able pay off the debt."*¹³

De Sousa also noted that continued donor support mitigates wider risks associated with the downgrade.¹⁴ Economist **Antonio Francisco**, however, warned that the downgrade increases the risk of defaults and warned that it has undermined the economic credibility of the Nyusi government.¹⁵ Francisco warned that the downgrade would attract speculators.

*"From the point of view of attracting good, productive investment this is very bad, and from the point of view of attracting toxic, speculative investment, it is good. Those who want to speculate here are finding their moment of opportunity."*¹⁶

Local media quoted former finance minister **Tomas Salomao** as criticising the opacity around the Ematum bond issue.¹⁷ **Manuel Chang**, finance minister at the time of the bond issue, has publicly refused to discuss Ematum.¹⁸

⁵ www.spratings.com

⁶ www.spratings.com

⁷ www.spratings.com

⁸ www.spratings.com

⁹ www.spratings.com

¹⁰ www.spratings.com

¹¹ Source, senior banking executive, UK

¹² O País, 14 Jul 2015.

¹³ O País, 14 Jul 2015.

¹⁴ O País, 14 Jul 2015.

¹⁵ O País, 14 Jul 2015.

¹⁶ O País, 14 Jul 2015.

¹⁷ O País, 8 Jul 2015.

¹⁸ O País, 8 Jul 2015.

Indian coal company CIL to abandon 75% of its two blocks in Mozambique

Indian state mining company **Coal India Ltd (CIL)** announced in early July that it plans to dispose of 75% of the area of the two coal blocks acquired in Mozambique's western **Tete Province**. The decision came after the government of Mozambique approved the doubling of the costs associated with maintaining coal blocks.¹⁹ CIL also claims that it was initially told that the two blocks contained a blended quantity of coking and thermal coal with reserves of around one billion tonnes, but a three-year prospecting programme revealed that over 75% of the combined area of the two blocks contained no viable coal resource base.²⁰ The Mozambique government says it has not yet received a formal notice from CIL with regard to its decision.

*"CIL allegations regarding the quality of coal are not always true. They cite as an example the case of **Rio Tinto** blocks in Tete, which, according to them, are at huge amounts and with good quality coal. However, according to them, the issue is that Rio Tinto did not wish to dig more than 300 metres in depth, where good quality could be found."*²¹

CIL purchased the concessions from Rio Tinto in July 2014 for \$50m. CIL alleged problems in both coal quality and the transportation of coal from Tete to the **Port of Beira**.

Despite CIL's decision, Mozambique's coal sector shows signs of recovery even with continued pressure from low international coal prices. The **Port of Nacala**, in the northern Mozambican province of **Nampula**, is due to start exporting coal from August, according to government-owned railway company **Caminhos de Ferro de Moçambique (CFM)**. **Brazil**-based international mining company **Vale**, which has the biggest coal reserves in Mozambique, operates the port and controls the **Nacala Integrated Logistics Corridor (CDN)**, which includes a port and a 900-km railway from **Moatize** (Tete Province) to Nacala.

*"Although analyst fear this may raise problems of competitiveness in the coal sector – as other coal companies may also need to use the same port operated by Vale – this is seen as an important step for Vale as it will reduce the company's costs with transport. Affected by coal prices crises, Vale has adopted a series of contingency measures, including reduction of workers ... and in social investment."*²²

Anadarko in talks to sell LNG to Japanese consortium

Anadarko Petroleum, a **United States**-based independent oil and gas exploration and production company, is in talks with **Jera**, a **Japan**-based consortium, for the long-term supply of liquefied natural gas (LNG) from the company's **Area 1** gas assets in Mozambique's **Rovuma** basin.²³ **Asia** is strategically important to the long-term success of Mozambique's LNG export industry. Anadarko has already selected a contractor for the construction of the LNG facility, which is expected to start soon. The LNG production plan calls for 12 million tonnes of LNG annually from Area 1, of which eight million tonnes is already under long-term contacts.²⁴ Neither Jera nor Anadarko has publicly released any details. Anadarko spokesperson **John Christiansen** said

*"We are progressing to long-term SPAs (sales and purchase agreements) with multiple customers in Asian markets, and we continue to make good progress with our marketing efforts."*²⁵

Anadarko signed a non-binding agreement with Japan-based **Toho Gas** in 2014 for the supply of 300,000 tonnes per year of Mozambican LNG.²⁶

¹⁹ Source, political analyst, Maputo

²⁰ Source, political analyst, Maputo

²¹ Source government geologist, Maputo

²² Source, Vale employee, Mozambique

²³ Multiple sources: Reuters, 25 Jun 2015; www.hydrocarbons-technology.com

²⁴ The Nation, 11 Jun 2015.

²⁵ Multiple sources: Reuters, 25 Jun 2015; www.hydrocarbons-technology.com

Jera is a joint venture between **Tokyo Electric Power Co (Tepco)** and **Chubu Electric**, Japan's third-biggest utility company. The two companies established Jera in April with the aim of becoming the cheapest LNG buyer in **East Asia**. Jera already handles all new long-term fuel purchases for Tepco and Chubu. From next year it will also handle all existing LNG supply contracts and purchases, amounting to 40 million metric tonnes per annum (MMtpa).²⁷

Anadarko holds a 26.5% stake in Area 1 along with Japan-based **Mitsui** (20%), **India**-based **ONGC Videsh** (16%), **Oil India Ltd** (4%), **India**-based **BPRL Ventures** (10%) and **Thailand**-based **PTT** (8.5%). Mozambique government-owned oil and gas company **Empresa Nacional de Hidrocarbonetos (ENH)** holds a 15% interest.²⁸

CIP says government is ignoring possible natural gas price fluctuations

The **Centre for Public Integrity (CIP)**, a Mozambique based non-governmental organisation (NGO) dedicated to the promotion of transparency, has claimed that the government has neglected the risk of possible natural gas price fluctuations in its estimates for expected export revenue.²⁹ The CIP points out that if prices are lower than expected, this will affect the government's tax revenue. Tax revenue will grow at a slower pace than anticipated in current forecasts, which will impact the government's future budgets.

*"The assessments of the potential revenue for the Mozambican state which derive from the **Rovuma** LNG are overwhelmingly concentrated on the volume of gas to be produced and the tax rates established in the contracts of 2006. There is little attention paid to the most important aspect in determining revenue to the State – the price at which the LNG will be sold."³⁰*

Moreover, due to the recent significant decline in international oil prices, there is now greater uncertainty with regards to international LNG prices than at any other time in recent decades, according to the CIP.³¹ The CIP maintains that the government should include price review clauses of at least five years duration, and destination clauses that ensure a fair division of profits if the gas is sent to an alternative market.³²

Implications

The political deadlock between the Frelimo government and Renamo will delay a final political agreement, but will not lead to a return to a full scale Renamo insurgency. Moreover, Renamo is unlikely to act on its threats to govern six northern provinces through force.

CIL's decision to exit most of its coal investments in Tete Province is a sign of how the increased pressure from lower international coal prices and lack of local infrastructure has negatively affected Mozambique's coal export sector. However, the start of coal exports from Nacala will reduce infrastructure cost pressures which will help balance the negative headwinds of lower international coal prices which are set to continue.

The Standard & Poor's sovereign credit downgrade will potentially increase the cost of international borrowing and the need for investors to secure increased partial risk guarantees. However, the risk of a sovereign default is low.

The uncertainty over future international LNG prices will make accurate forecasting of future government export revenues more uncertain, which will make government fiscal position less predictable when LNG exports come online some time between 2018 and 2021.

²⁶ Multiple sources: Reuters, 25 Jun 2015; www.hydrocarbons-technology.com

²⁷ Multiple sources: Reuters, 25 Jun 2015; www.hydrocarbons-technology.com

²⁸ www.allafrica.com

²⁹ 'Gas Sale Agreements for Liquefied Natural Gas: Price Determination and Implications for State Revenue', quoted in Lusa, 21 Jul 2015.

³⁰ Lusa, 21 Jul 2015.

³¹ Lusa, 21 Jul 2015.

³² Lusa, 21 Jul 2015.

Forthcoming political and business events

Portuguese Speaking Countries Peace Conference – Maputo, 24 July 2015

Brazil-Mozambique Business Mission – Maputo, 30 July 2015

About Africa Risk Consulting:

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